REPORT AND RECOMMENDATION OF THE GOVERNORS SPECIAL COMMISSION RELATIVE TO THE ESTABLISHMENT OF A DAIRY STABILIZATION FUND

Presented To: General Court
Submitted By: Special Commission
Dated: May 20, 1991

MEMORANDUM

To: General Court
From: Special Commission
Dated: May 20, 1991

Subject: Results of Study and Recommendations
Establishment of Dairy Stabilization Fund

REPORT SUBSEQUENT TO PUBLIC HEARINGS

I. Establishment of Special Commission

Recognizing the critical situation, the General Court, on December 20, 1990, resolved that a special commission be established to investigate and study the dairy industry in Massachusetts. The commission was charged with holding at least one public hearing and reporting to the General Court the results of its investigation together with its recommendations and draft legislation necessary to carry out the recommendations.

The commission, in conjunction with the Department of Food and Agriculture, held three public hearings and met on several occasions to discuss the necessary recommendations. Below is a discussion of the testimony received at the public hearings, the results of the investigation and the recommended course of action.

For your consideration and assistance, a statement of the history of the current crisis effecting the local dairy farmers, an explanation of the federal and state regulatory systems governing fluid milk sales, and a summary of the testimony by comment area are provided.

II. Public Notice

Public hearings were conducted at the University of Massachusetts, Amherst on May 6, 1991; One Ashburton Place on May 7, 1991 and the Worcester Horticultural Society on May 7, 1991 in order to hear and receive testimony from interested parties concerning the state of the dairy industry in Massachusetts.

Notice of the hearings was provided by the following methods:

Published in:

- Springfield Union News on April 15, 1991.
- Boston Herald on April 15, 1991.

Filed with:
- Executive Office of Communities and Development
- Secretary of State, Regulations Division

Approximately 317 people attended the public hearings: 87 people presented oral testimony; 87 submitted written testimony.

(References in this report to "the Department", unless the context indicates otherwise, means the Department of Food and Agriculture.)

III. Introduction

Massachusetts dairy farmers have been the stewards of the commonwealths land since the first decade of the sixteenth century. Since that time, they continuously provided the citizens of this Commonwealth with an abundant supply of an essential commodity: fresh milk. It has only been during the past ten years that the local dairy farmers have been forced to sell their farms due to drastic losses of income. They have either gone bankrupt or been forced to sell their land as it became impossible to operate the farm as a sustainable business.

This loss of profitability was not due to the farmers mismanagement or inefficiency. They became the subjects of an industry slowly being overrun by big business in the larger milk producing states in the mid-west. From 1980 to date, Massachusetts has lost 434 farms, a decline of 829 to 395: approximately 48% of our dairies.

Right now, our farmers are facing a crisis. The price of milk, established by a complex set of federal regulations, has declined 30% in the past year and, in fact, is at the same level as set by the federal government in 1978. Although the cost of production has increased over the last thirteen years, farmers are being paid a price for their product at a level $3.00/cwt below their cost of production. Much of the problem stems from the archaic system which governs pricing of milk.

It is undisputed, by farmers and dealers, that if the price paid to farmers for their milk is not significantly increased immediately, a majority of the remaining Massachusetts dairy farmers will be forced out of business within the year. The importance of supporting this industry, and the nearly 300,000 acres of well maintained open land it preserves in the Commonwealth, was emphasized throughout the hearings. Without the continued existence of dairy farmers, the Commonwealth will lose its supply of locally produced fresh milk, together with the open lands that are used as wildlife refuges, for recreation, hunting, fishing, tourism, and education.

We are all aware that taking action to provide the farmers with a fair price for their product may cost the milk consumer money, but, a loss of these local farms will cost the consumer more, both monetarily and environmentally.

IV. Federal Price Setting Scheme

In order to understand the reasons Massachusetts farmers are facing the current problem, it is necessary to review the system which establishes milk pricing. For a majority of the country, the price which farmers are paid for their milk is established by the federal government. The Agricultural Agreement Act was established by Congress in 1937 in order to protect the dairy industry and ensure the survival of dairy farming. The Act provides for the creation of federal milk marketing orders which create a complicated system for determining what price farmers will be paid for the milk they produce. The original intent being to stabilize prices to ensure a continuous supply of milk.

The base price for this system is established by a monthly survey of farmgate prices for "manufacturing" milk in Minnesota and Wisconsin, the "M-W price". The M-W price is the average price paid by approximately 110 cheese, butter and powdered milk manufacturing plants for Grade B milk in the Minnesota-Wisconsin area. (Grade B Milk cannot be sold for fluid consumption. It can only be used for manufactured products).

These plants in the Minnesota-Wisconsin area pay a price for milk which is a total free market price and is influenced by factors such as milk supply/seasonal supply, feed costs, and price supports. There is no regulatory system which determines what these plants must pay to the dairymen in these areas. Each month a survey is taken to determine the average that these plants pay for milk. That average becomes the M-W price -- in essence the basis upon which the price of milk virtually everywhere else in the U.S. is determined.

When there is a surplus of milk, the federal government (via its purchases) becomes the major factor in the milk market and the federal support price (the minimum price the government will pay dairy farmers for their [Class B] milk used to make manufactured dairy products) sets the M-W price. The huge factory farms in California and the Southwest are primarily responsible for creating these surpluses by using taxpayer-subsidized water to raise feed year-round and produce enormous quantities of cheap milk.

The ultimate price paid to farmers in other areas of the country are determined through a complex and convoluted formula which supposedly makes allowance for regional differences in production costs, supply and demand, ultimate utilization of the finished product, etc. Regrettably, this formula, however effective it may once have been, no longer reflects the distinct and unique needs of the New England region in general nor Massachusetts in particular.

The M-W price does not adequately reflect the significantly higher costs of maintaining an agricultural enterprise in this area of the country, particularly since the industry in the M-W region consists largely of "factory farms", with huge herds, vast acreage, and the ready availability of both supplies and labor, as opposed to New England where small, family operations are the rule. Another inequity of the current procedure is that every facet of production is not always calculated into the federally-mandated price. For example, the state of California has become a huge supplier of low-cost milk in recent years, a fact made possible by the ready availability of water from various federally-funded projects. This essentially provided an invisible subsidy to the California milk industry at the expense of other areas of the country.

Recent events demonstrate that this system no longer accomplishes its goal nor provides a stable, minimum price for dairy farmers operating in New England and the northeast. The January, 1991 blend price for Federal Milk Order I was twenty seven percent (27%) less than the January, 1990 price. This represents the largest year-to-year change in the history of the New England Order. This precipitous drop in the federal market order price for milk is part of a decade-long trend of decreasing prices paid to farmers that poses an unprecedented threat to the viability of the region's dairy industry.

The average Northeast dairy farmer's 1989 milk price was $14.46 per hundredweight (cwt: 100 pounds of milk: 11.6 gallons). This was $1.41/cwt higher than in 1988 and represented their best year of the decade. Nonetheless these prices were still below 1979 levels. Net earnings per cow in 1979 was $249 compared to $121 in 1989.

Not only did prices continue to fall but, the costs of production rose, health standards became more stringent, and production equipment became outdated. Dairy farmers' cost of producing milk increased by $1.00/cwt. in 1989 to $13.95/cwt. This figure does not include a return on the $33.00/cwt. of the farmer's own equity invested in his or her business. Higher feed prices caused expenses to increase by $61.00 per cow or $.32/cwt. The average dairy farmer's interest expense increased $21.00 per cow in 1989.

Presently, there is no commodity, with the possible exception of alcoholic beverages, as heavily regulated and controlled as is the milk.

V. Other New England States

The problem discussed above is not unique to Massachusetts. The other New England states also recognize the crisis facing their dairy farmers. While these states have all discussed

entering into a regional compact to set uniform prices throughout the region, it is acknowledged by those involved that such a compact could take as long as five years to go into effect; requiring Congressional approval.

Although theses states are reviewing legislation to implement the compact, they recognize the need for immediate action and each have legislation pending to raise the price paid to their dairy farmers. These states include Maine, Vermont, New Hampshire, New York, Connecticut and Rhode Islands.

VI. Testimony

Participation at the hearings was extensive. Realizing the broad impact of the problem, a diverse group of people presented both oral and written testimony including consumers, land preservationists, environmentalists, sportsmen, business people, farmers, milk handlers and dealers, local officials and state representatives and senators.

Attached are the sign in sheets from the hearings for those people who presented oral testimony. A list of names of the persons who submitted written comments, or a copy of the comments, is available upon request.

VII. DISCUSSION OF TESTIMONY

For organizational purposes, the areas of comment are organized by interest group and the particular concerns relating to the crisis:

<u>CONSUMER/PUBLIC</u>

Through over nine hours of public testimony, not one voice spoke out in opposition to increasing the price farmers are paid for their milk. Rather, uniformly, these constituents expressed concern over losing the rural character of Massachusetts. Many of the people who testified identified their interest in the situation relating to the preservation of farmland and open space. The overriding concern was not that the retail price of milk would be raised, but that the natural characteristics of the Commonwealth would be gone forever if we lost our dairy industry.

In reality, the estimated two cent increase per quart of milk would not be noticed by the consuming public. There is already a great disparity in price, about twenty cents per gallon, between the different brands of milk sold in stores. In addition, the price of milk in Massachusetts in twenty six cents a gallon less than the national average. Most importantly,

although the price paid to farmers for their milk has dropped thirty percent in the last year, the retail price has not decreased proportionately. The consumer has not benefitted from the lower milk prices as the retail stores continue to reap the profits.

Consumers are not adverse to paying an additional two cents in order to "save" the local dairies. These constituents realized that the benefits received by the citizens of Massachusetts far outweigh any minor increase in the retail price of milk. Farmers have always been very generous with sharing their land and allow the public to utilize this 300,000 acres for a variety of activities including horseback riding, snowmobiling, skiing, hunting and fishing.

The National Rifle Association, the sportsman's clubs and land trusts have unanimously spoken out in favor of supporting the dairy industry. They stress the fact that if these acres are not preserved, a national heritage, accessible open space and the character of our land will be lost forever.

Environmental groups also stressed that this land provides increasingly necessary habitat for wildlife and protects the land from development and further environmental degradation. One national group also stressed that small farmers are better able to control their use of pesticides and protect our resources than large scale agri-businesses.

Most importantly perhaps, the consumers realize that if local dairies are not producing, our milk will be trucked in from other states like Pennsylvania and Ohio. As an extremely perishable item, the milk will not be as fresh, will not be able to retained for as long in the stores or at home and will support the dairy industries of other states for an even higher cost to the local consumer. It costs an average of four cents per hundredweight (.40/cwt) to ship milk every 100 miles.

If our local supply of milk is not protected, the Massachusetts consumers' cost of milk will greatly increase and the citizens of Massachusetts will become entirely dependent on other states to ensure a supply of an essential commodity. The public unconditionally supported an increase in the price farmers are paid for their milk, stressing that their interests are not in conflict with that of the farmers. The inevitable harms associated with the loss of the dairy farmer are far greater than the potential rise in milk prices.

RELATED AGRICULTURAL BUSINESSES

The loss of these farms will not only impact the dairy farmers, but the effect will ripple into a variety of related businesses. Many of the people who testified are operating agriculture related companies such as farm equipment sales, feed stores, artificial insemination services, farm credit institutions and the like. Each of these groups are in favor of the state increasing the amount dairy farmers are paid for their milk.

As each dairy farms goes out of business, these related industries lose a customer and find it less and less profitable to stay in business in Massachusetts. These businesses may also not be paid on amounts owed for many months, or not at all. As each one of these businesses decides to close their local offices, other farmers, both dairy and non-dairy, are effected. Each farmer has to travel farther to obtain these services, continually increasing the cost of their production.

These businesses have already noted that their accounts receivables are down considerably since last year. As generators of millions of dollars of income, these businesses are an integral part of our states economy and will contribute to the states economic hardships if forced to move their offices to neighboring states. It is important that the infrastructure of the agricultural businesses of this state are preserved. Increasing the amount farmers are paid for their milk will insure the future viability of the related community.

DAIRY FARMERS

A majority of the offered testimony was provided by the state's dairy farmers, in unequivocal support of the establishment of a milk price higher than the federal milk order price. The farmers stated that they are not looking for a "hand out" but they are asking that they get paid a "fair" price for their product. As the sale of milk is not based upon a free market system, Massachusetts farmers have no control over the price they are paid for their milk. It is the federal and state governments obligation to establish a price for milk which will stabilize and ensure the future viability of the dairy industry.

At the focal point of the farmers testimony was the fact that the current price they are paid for their milk is the same price as they were paid in 1979. The overall price for milk has steadily been declining over the last ten years whereas the cost of production has continually increased. Clearly, this presents an extremely bleak picture to our farmers.

Virtually every factor of production required in their business has significantly increased in cost since 1979. Although each farmer is operating under a unique set of conditions, the experience of one farmer may serve to illustrate the problem:

> In 1979 this farms feed bill was $38,700, today it is $108,000; fertilizer costs of $4,675 have now grown to $34,330; utilities have risen from $2,220 to $11,020; insurance costs have risen from $1,146 to $6,074; tax levies have gone from $2,065 to $14,878, rent from $1,040 to $6,390 and interest payments from $350 to $7,737. Even a minor item, such as sawdust bedding for the animals, has increased from $155 to $7,420.
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> The operating expenses for this farm have increased approximately 400% and yet, they are receiving the same price for their milk as in 1979. Clearly, they can not continue to operate on this basis for very long.

Furthermore, most Massachusetts farms have increased production significantly over the years, in some instances as much as 20% and more. Thus, the problems facing the industry are not the result of inefficient operations or mismanagement. Similarly, it has been suggested that farmers, in attempting to raise their incomes, have increased production to the point where they have created a surplus of the product, glutting the market and lowering prices. On the other hand, it is generally agreed that any surplus production of milk amounts to only some 6% over present consumption levels. It does not seem reasonable to argue that an oversupply of only 6% of any product would result in a drop of nearly 50% in wholesale prices on the total amount of that product produced nationwide. In either event, the surplus is not created by Massachusetts farmers - as a heavily consuming state, this Commonwealth only produces approximately one third of the milk we consume.

As indicated, the problem facing the Massachusetts dairy farmer is a drastic decline in milk prices with increases in cost of production. It is estimated that it costs an average of $15.00/cwt to produce milk. The Order I blend price paid to farmers for their milk in April of 1991 was $ 11.94: resulting in a loss of $4.06 for each cwt produced.

Not only is the economic tightrope getting longer for the producers, their safety rope is also slipping. Each spring many farmers borrow funds to purchase supplies, including fertilizer and seed, for their yearly planting. This amount is then repaid in the fall, after the peak production season. As the Farm Credit Bank estimates that the farmers cost of production is higher than the amount paid for the product, they are continually

refusing to extend credit. Without the ability to produce the feed for the cows, and a lack of money to purchase feed, the farmer is unable to maintain the herd.

There is no other industry in which a producers has no choice but to sell his product below cost at an artificially set price. Without an increase in their price, the dairy farmers have stated that they will have no alternative but to sell their farms for development and abandon the way of life which their families have chosen for several generations.

DEALERS

The Association of New England Milk Dealers has submitted testimony in support of a price increase for fluid milk. The milk dealers realize that their success is tied to the survival of milk producers. Since the dealers operate on a regional level, however, their testimony stresses the need for a regional solution - to place all dealers on an equal purchasing field.

As acknowledged earlier, all the New England states realize that a regional compact is desirable in order to sustain the regional dairy industry in the future. Such a compact, after authorization by Congress, would allow the states to negotiate for the terms and prices for milk purchased within the entire region. In the interim, prices must be raised within each state. The dealers do not oppose a price increase, but have expressed concern over the funds being deposited into a state account for redistribution, and not paid directly to the farmers.

Practical aspects of a price increase require that monies generated from the increase be placed into a fund and redistributed to the farmers in relation to the amount of milk produced by them. So long as a trust account is established for the placement of these funds, the dealers fear - that the money will be deposited into the general fund and appropriated for other uses - is unfounded. The envisioned scheme is not a tax, and the monies would not be deposited into the general fund. The necessary program would raise the price a farmer receives for his milk and the money would be distributed, from a trust fund, to the farmer.

So long as the pricing increase is applied equally to all dealers, those located within and out of state, dealers selling in Massachusetts will not be placed at a disadvantage. Furthermore, since the dealers negotiate the price they are paid for their product on a free market basis, they can pass any increased cost along to the retailer, and eventually the consumer who supports this increase.

VIII. CONCLUSION

An increase in the price Massachusetts dairy farmers are paid for their milk is essential. As the cost of production is approximately $15.00 and the current blend price they are paid by handlers is 11.94, an increase of 4.06/cwt is warranted. Since, however, the federally established price of milk is constantly changing, the increase should be based on a sliding scale to meet the intent of the program: to stabilize milk prices and ensure the viability of the Massachusetts dairy industry.

This increase can be accomplished by adopting legislation mandating the dealers to pay an established amount, based on the amount of fluid milk they sell in Massachusetts, into a fund. The money in this fund would then be distributed back to the farmer, providing them with a fair price for the milk.

By establishing this increase, the Commonwealth will acknowledge its commitment to ensuring that its citizens are provided with a supply of fresh milk; promoting the survival of our national heritage; promoting agricultural industries; maintaining an educational foundation for future generations; preserving our ever decreasing open lands and tourism; and establishing preserves for wildlife and recreation.

IX. RECOMMENDATIONS

After extensive study, the Governors Special Commission Relative to the Establishment of a Dairy Stabilization Fund recommends that House Bill No. 4390, as amended, be adopted; and review of House Bill No. 1964 (Compact) commence immediately. Upon redraft, the Compact should be adopted as soon as possible.